Volume 7 | Issue 3 Article 3

4-1945

Savings and Loan Associations

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Savings and Loan Associations

By FRANCES SADAUSKAS, *Chicago, Illinois*

It is surprising how many persons, even among accountants, will think of a bank or short-term loan company,—the type that advertises "money on your signature"—when mention is made of a savings and loan association.

It is also surprising that the examiners who create the questions for CPA examinations do not include questions regularly on savings and loan associations as they do on other financial institutions.

According to the statistical data compiled by the United States Savings and Loan League, there were 6,511 associations in the country at the close of 1943, having assets in excess of $6,593,283,234.

Undoubtedly, the savings and loan association today is such a definite, permanent and vital part of our lives that all should be apprised of its characteristics. Possibly the simplest and best definition is embodied right in the statutes; the Building, Loan and Homestead Act of Illinois describes it as an association organized "for the purpose of assisting its members to accumulate and invest their savings . . . to be loaned among its members."

The idea is an old one, having existed in Europe in varied form. The first association chartered in America in 1831 was patterned after such organizations in England.

The one item that is specifically peculiar to savings and loan associations, and which places them in a class different from banks or other financial institutions, is the membership feature. The very act of opening an account, no matter how small or large, automatically makes one a shareholding member of the association, the number of shares determined by the class of savings, the bylaws and/or the statutes. As a shareholder, one has the right to attend the annual or special shareholders' meetings, to vote on business matters, to elect the directors and to be elected a director.

Originally, when, through the accumulation of the members' savings, the association's treasury became sufficiently large to make loans, the money was offered in open meeting and, quoting from Illinois law, ". . . the member who shall bid the highest premium for the preference or priority of loan, shall be entitled to a loan of one hundred dollars for each share held by said member. . ."

However, as treasuries grew to substantial amounts and monies were generally loaned and borrowed at more or less standard rates, the laws were amended to allow a savings and loan association ". . . to dispense with the offering of its money for bids in open meeting and in lieu thereof," as the Illinois Act reads, "loan its money at a rate of interest, or interest and premium, to be fixed by the directors, deciding the preference or priority of the right to a loan by the priority of the approved application therefor of its shareholders."

This opened the way for non-members to apply for loans and, if their applications were approved, they subscribed to as many shares as their loans required, one share per each hundred dollars of loan. Thus they became "borrowing" members and acquired the same voting powers as "saving" members.

Such loans, however, are strictly limited to mortgage loans on real property and they must comprise first liens on the property and fall within prescribed percentages of the valuation of the property in accordance with the bylaws of the association, the statutes of the respective states, and the rules and regulations of the Federal Home Loan Bank Board. Some of the chief purposes for which the loans are made are to purchase, build, remodel or rehabilitate a home or to refinance a burdensome old mortgage.

The need to approve or reject applications for loans, made it necessary for the directors to appraise the property which was to be mortgaged, to pass opinion on the borrower's ability to make repayments regularly and to decide if the making of the loan would be a sound way of investing the money of the saving members. Some associations continue to have appraising committees from among their own directors, while others turn to professional appraisers for such service.

Repayments on the loans are made according to one of several plans, namely, the Direct Reduction plan, the Share Purchase plan, which is a variation of the sinking fund method, the FHA plan and occasionally the Straight Mortgage plan.

It was the latter, the Straight Mortgage plan, generally used by most financial institutions, which was the cause of numerous foreclosures in depression years. The mortgagor was obliged to pay interest faithfully on the due dates, while the principal was payable in a lump sum at the expiration of the loan term. This resulted in repeated renewals of the mortgage, with the added expense of renewed costs, for somehow it was always impossible for most mortgagors to save enough to repay the principal.

The Share Purchase plan, used by savings and loan associations from their very inception, was a great step in alleviating the difficulties in the repayment of mortgages. After the consummation of a loan, interest had to be paid periodically, but, at the same time, reasonable additional payments had to be made either monthly or so much in each series (usually a three-month period) into a savings account, which was pledged as collateral security for the loan. The amount being accumulated through such savings was further increased by the profits apportioned thereto at the regular profit distribution periods. As soon as such savings plus the profits were sufficient to repay the principal, the transaction was cleared on the books through vouchers and journal entries, or through the cashbook, and the proper release papers were executed.

Incidentally, the effective interest rate on Share Purchase loans is the stated interest less the profits apportioned to the pledged share account.

The Direct Reduction plan is probably the most popular today and the best liked. A definite, stipulated payment is made each month, comparable to rent payments, and is applied, in part, to cover the month's interest charges and, the balance, as a reduction of the loan. Each succeeding month the interest charges are computed on the remaining balances, which results in continuously decreasing interest charges and increasing repayments of the loan.

Since the Direct Reduction plan allows larger payments to be made than stipulated, in quicker reduction of the principal, if the borrower so desire, many a family has been able to secure a home through this method without undue privation and to repay a goodly-sized mortgage in possibly twelve, ten, seven years or less.

Payments on FHA loans are monthly payments similar to the Direct Reduction plan. However, they are computed to cover not only the monthly interest charges and a portion of the principal, but also an approximate one-twelfth of the annual real estate taxes and insurance premium.

Pursuant to the Servicemen's Readjustment Act of 1944, savings and loan associations are starting also to make "G.I." loans.

Repayments will follow a monthly basis on the order of FHA loans.

Although mortgage loans represent the main item of the assets of a savings and loan association, some balance sheets still carry "share loans." Not wanting to disturb his savings, a member may borrow money, pledging his savings account shares as collateral, and then repay such share loan, plus interest, whenever convenient. However, at the present time, such share loans are subject to the limitations under Federal Regulation "W."

Other asset items on the balance sheet of a savings and loan association may include any or all of the following:

Accruals of Interest and Premiums on any or all types of loans just mentioned.

Real Estate in Judgment and Foreclosure which occurs in extreme cases of delinquency in the repayment of mortgage loans.

Real Estate Owned, taken over only in extreme cases of delinquency and held only until sold, with effort made to sell as quickly as possible.

Real Estate Sold on Contract.

Accrued Interest on Contracts.

Advances for Taxes and Insurance on any or all types of mortgage loans and on real estate contracts.

Investment in Federal Home Loan Bank Stock required of insured associations and of non-insured associations wishing membership in the Federal Home Loan Bank System for privilege of borrowing money therefrom, etc.

Investment in U. S. Bonds and Treasury Certificates initiated in recent war years, since the government needed money and the associations had surplus funds because of scarcity of mortgage loans.

Other Investments as shares of other insured savings and loan associations.

Cash on Hand and in Banks.

Office Building.

Furniture and Fixtures.

Deferred Charges.

Installments on Shares Due and Unpaid.

Accounts Receivable.

Rents Receivable, either from real estate owned and operated during interim until sold, or rents from space in office building.

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This list is by no means exhaustive, but, in our opinion, suggestive enough.

The main item on the liabilities side will be the savings accounts of the shareholders, shown in one aggregate sum or detailed as to classes, perhaps, as follows:

Installments on Mortgage Pledged Shares.

Installments on Serial Investment Shares.

Installments Paid in Advance.

Installments Due and Unpaid (contra entry to similar caption on assets side).

Optional Payment Shares.

Bonus Thrift Shares.

Prepaid Shares.

Paid-Up Shares.

Matured Shares Awaiting Payment.

No one association will necessarily carry all of these classes, but only whatever its bylaws and/or state statutes provide.

It is not the intention of this article to go into lengthy detail and, therefore, the technical differences between all of the classes will not be discussed here. However, it is an interesting fact, which should be mentioned, that the Serial Investment and Mortgage Pledged Shares were the most popular type of shares in the early years of all savings and loan associations. This class induced regular and systematic saving, for in subscribing to this type of shares, one pledged to invest a stated amount in each series, payable in installments over the series period, which usually was three months. Nowadays the trend seems to be toward Optional Payment Shares and Paid-Up shares. At least, that is the writer's opinion based on information secured through audits of savings and loan associations in northern Illinois.

One very obvious reason for the change in the type of investment seems to be that in the case of Paid-Up Shares, the saving member invests a certain sum of money, receiving a certificate therefor, and then enjoys the freedom of having nothing else to do about it except to cash the dividend check mailed to him every semi-annual period, or whatever the profit distribution period may be.

In the Optional Payment class, the dividends are posted into the savings passbook and become part of the dues' capital, which means the share-holder can see how his savings are growing, pleasantly augmented by the periodical distribution of the association's profits.

The profits divided to and reserved for the Serial Installment Shares, both the investment and the pledged shares, are carried only as a general ledger figure, usually not being posted into the passbooks, but a schedule being carried by the association showing the profits accumulated per share for each series, to be paid upon maturity of the series or upon withdrawal before maturity and then subject to certain fines or penalties if the dues were not fully paid to date or had not been invested for a prescribed period.

Several methods of profit distribution are in use, such as the Partnership, the Rice and the Dexter methods. As a base, all use the dues or installments that should have been paid in, as per the pledge or certificate, plus an equated portion of the installments that should have been paid in during the period concerned.

The Partnership and Rice methods merge the prior years' profits into a pool with the current available profits and make a redistribution each period at the current rate applicable retroactively for all the years that the respective series of shares have been in force. This means that if profits had been distributed in early years at the rate of 4%, those who withdrew in the preceding years, took their 4% dividends; while now, if the current year's operations were at a deficit and the accumulated profits were proportionately diminished, resulting in a 3% dividend, the present shareholders would receive, upon maturity or withrawal, the lower earnings for all their years of membership.

The Dexter method does not disturb previous distributions and provides for compound profit distribution to Serial Shares, which is more equitable in view of the fact that Optional Shares usually receive compound profits by virtue of the dividends apportioned thereto becoming part of the dues' capital.

All three methods named assume a certain available sum of dollars and cents to be distributed and thence they proceed to determine the gain per dollar of earning power per series and finally the gain per share. This, however, is definitely outmoded.

With today's efficient accounting systems, budgets and close-to-accurate Estimated Statements of Profit and Loss, the modern association is able to declare in advance the dividend rate or rates equitable to all classes of shares in respect of their certificate requirements or limitations, bearing in mind that, of the profits earned, only a reasonable portion may be distributed to the shareholders and that a sufficient part of the profits must be retained for purposes of adding to necessary specific reserves and building up general reserves.

The simplest and most workable formula for present day computation of profit distribution to Serial shares, according to a modified Dexter plan, is as follows:

Total Value per Share, which includes installments plus profits accumulated to the beginning of the current period

Plus

One-half the Dues that should have been paid per share during the current period, which thus gives the base value per share to be

Multiplied By

The Current Dividend Rate, as declared by the Board of Directors, which product should then be

Added To

The Total Profits Per Share carried at the beginning of the period to arrive at the total profits per share at the end of the period and this amount

Multiplied By

The Total Number of Shares in the series so as to determine the total profits per series,—this to be done, by series, for all series in force to arrive at the aggregate total of profits that should be set aside for Serial Installment Shares.

Is it any wonder that the personnel of savings and loan associations is not encouraging members to subscribe to this class of shares? Yet, it is unfortunate because, as stated before, this class induced regular, systematic saving and was really the root for savings and loan association growth.

The profits apportioned to Paid-Up shares are usually carried as "Dividends Payable" on the balance sheet, apart from the other "Profits Divided" accounts.

Other liability accounts on the balance sheet may include:

Advances from Federal Home Loan Bank or from other banks.

Accrued Interest on Advances.

Amount Due Federal Reserve Bank for war bonds sold to the public, which is an innovation in savings and loan association activities since World War II.

Taxes Accrued and Unpaid.

Accounts Payable.

Loans in Process, offsetting mortgage loans made by the amount that has not been paid out to the borrower for such reasons as awaiting the clearance of title, awaiting proper waivers of lien in case of construction loans, or amounts retained to cover possible litigation.

Escrow Advances for Taxes or Insurance.

Deferred Credit accounts might be carried to show unearned profits on contracts, income collected in advance, or unearned discount on F.H.A. Notes.

Specific Reserve accounts may be set up for uncollected interest, real estate taxes not due, or for valuation of specific real estate or other assets.

General Reserve accounts may include:

Contingent Reserve.

Federal Insurance Reserve in cases where the accounts are insured by the Federal Savings and Loan Insurance Corporation.

Other Special Reserves.

Finally, there will be a surplus account, usually called "Undivided Profits," which is limited by state statutes and other regulations to a certain percentage of assets or shareholders' investment.

The general reserve accounts, also, have to meet with certain requirements as per state statutes and rules and regulations of the Insuring corporation.

The income and expense accounts may readily be implied from the nature of the asset and liability accounts, with other accounts to be added for the actual operating expenses.

As to the audit procedure to be followed by accountants engaged in auditing savings and loan associations, the best sources of information are the instructions and bulletins issued by the offices of the Auditor of Public Accounts of the respective states wherein the associations are chartered, the rules and regulations of the Federal Home Loan Bank Board, as well as the publications of the American Institute of Accountants.

The work of both, the public accountant making the audit and the accountant working full time in an office of a savings and loan association, is interesting and alive!

The savings and loan association today takes part in every phase of modern life. It helps people save money. It helps people acquire and maintain a home, and in this respect, alone, the spread of savings and loan associations has been of immeasurable importance in the building of this great country. There has probably never been quoted a slogan more true than that adopted by the savings and loan movement,—"Home ownership is the best safeguard of democracy and liberty."

The savings and loan association helps with the war effort by investing its own funds in government securities and by acting as an agent of the United States Treasury in the sale of bonds to the public.

With the introduction of "G.I." loans, the savings and loan association will help the veteran in the postwar period.

Subscription to its shares is not the rare privilege of the few, but, in most states, open to all: men, women, married or single, children, corporations, trustees, executors, administrators, guardians and other fiduciaries. Only a few states are left where the laws have been slow in opening this opportunity of sound investment to all their constituents.

To know a little about a savings and loan association leads one to make an effort to learn all and to understand its purpose and operation thoroughly, and then one becomes its member. Next, one aspires to directorship. Finally, if one is a public accountant and is interested in auditing a savings and loan association, the choice is heartbreaking: auditor or director, for one may not be both, according to the accepted definition of an "independent" public accountant.

However, one MAY be a member!—and as such it is indeed gratifying to invest a dollar and know that at the same time that you are building an egg-nest fund for yourself, your dollar is helping another family, possibly another accountant, to acquire a nest, a home.

A savings and loan association is a symbol of progress in any community.